

Internal Revenue Service
memorandum

CC:TL
Br4:RBWeinstock

date: 8 OCT 1986

to: District Counsel, Cincinnati MW:CIN
Attn: Ronald T. Jordan

from: Director, Tax Litigation Division CC:TL

subject: [REDACTED]

This is in response to your request for technical advice dated August 29, 1986, in the above-entitled action.

Issue

Whether a national college fraternity exempt from tax under I.R.C. § 501(c)(7) which uses a portion of its investment income to publish its magazine may treat as exempt function income (within the meaning of section 512(b)(3)(B)) the portion of the investment income representing the portion of the magazine that is devoted to educational and charitable purposes (as opposed to social and administrative purposes). 00512.09-03.

CONCLUSION

Because the publication of the fraternity's magazine is devoted to substantial nonexempt purposes, and only incidentally is devoted to educational and charitable purposes, no portion of its investment income set aside to publish the magazine qualifies as exempt function income.

Facts

[REDACTED] is an [REDACTED] not-for-profit organization recognized as exempt under I.R.C. § 501(c)(7). It is a national college fraternity and has received a group exemption which includes its subordinate chapters. The fraternity's investment income is used for loans on local chapter housing, leadership and citizenship schools and services, and for the publication of a national magazine, "[REDACTED]".

The funds which generate the income necessary to publish "[REDACTED]" are held in the [REDACTED]. The income from the fund is restricted in its use to support "[REDACTED]" and may not be used for other purposes. The fraternity took the position that the interest income from the [REDACTED] is set aside to support an educational or charitable activity and the net amounts received are therefore not subject to tax under section 512.

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The fraternity's argument was considered in [REDACTED]

"[REDACTED]" was not published primarily for charitable or educational purposes, and therefore, the net investment income used to publish "[REDACTED]" did not constitute exempt function income" within the meaning of section 512(a)(3)(B). [REDACTED] found that publication of "[REDACTED]" substantially furthered the fraternity's social and administrative purposes, [REDACTED] and only an insubstantial portion of the material published qualified as educational. [REDACTED]

The fraternity had suggested "that the Service should apply a 'fractionalization' approach whereby, based on a page-by-page review of the magazine, expenses of the educational portion of the publication [would] qualify for allocation to set aside funds." However, this was rejected as inapplicable where an activity has a substantial nonexempt purpose, citing Better Business Bureau v. United States, 326 US 279, 283 (1945). [REDACTED]

The technical advice request suggests that the [REDACTED] is in direct conflict with a technical advice memorandum, PLR 8452005, which allowed a fraternity to allocate certain expenses relating to chapter visits by the national fraternity's chapter consultants and national meetings between educational or charitable (i.e., exempt), and nonexempt activities. The fraternity in PLR 8452005 maintained two separate funds, Y and Z. Y was a set aside of investment income for the fraternity's charitable and educational activities, whereas Z was used for program service, management and fund raising expenses. Funds in the Y Fund were used for chapter visitation expenses, formal meeting expenses and reimbursement to the Z Fund for an allocation of certain expenses borne by the Z fund but related to the educational fund. The Z fund paid these expenses for convenience.

DISCUSSION

Section 512(a)(3)(A) excludes from the unrelated business taxable income of organizations described in section 501(c)(7) exempt function income.

Section 512(b)(3)(B) defines "exempt function income" as gross income from dues, fees, charges, or other similar amounts paid by members of the organization as consideration for providing such members or their dependents or guest goods, facilities, or services in furtherance of the purposes constituting the basis for exemption of the organization to which such income is paid. Such term also means (with an exemption not pertinent here) all income which is set aside for a purpose specified in section 170(c)(4).

The purposes specified in section 170(c)(4) include religious, charitable, scientific, literary, or educational, or for the prevention of cruelty to children or animals.

Treasury Regulation § 1.501(c)(3)-1(d)(3)(i) defines "educational" as (a) the instruction or training of the individual for the purpose of improving or developing his capabilities; or (b) the instruction of the public on subjects useful to the individual and beneficial to the community.

Prop. Treas. Reg. §1.512(a)-3(c)(3)(iii) further provides that "in the case of a national organization of college fraternities or sororities, income may be set aside for scholarships, student loans, loans on local chapter housing, leadership and citizenship schools and services and similar purposes."

The proposed regulation is based on S. Rep. No. 91-552, 91st Cong., 1st Sess. 72 (1969), 1969-3 C.B. 470, which discussed the amendments to section 512 made by the Tax Reform Act of 1969. The Senate report states,

... In extending the exemption, the committee intends in the case of national organizations of college fraternities and sororities that amounts set aside for scholarships, student loans, loans on local chapter housing, leadership and citizenship schools and services, and similar activities, be classified as amounts used for educational or charitable purposes under this provision.

Treasury Regulation § 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not operated exclusively for exempt purposes unless it serves a public rather than a private interest. To satisfy this requirement, the organization seeking recognition must establish that it is not organized or operated for the benefit of private interests such as designated individuals. Further, if private interests are served by the activities of the organization, and are more than insubstantial, exemption under section 501(c)(3) is precluded, regardless of the number of importance of truly exempt purposes. Better Business Bureau v. United States, 326 U.S. 279, 283 (1945).

Prop. Treas. Reg. §1.512(a)-3(c)(v) provides certain requirements for a set aside, including the net income must be specifically earmarked as such or placed in a separate account or fund. The proposed regulations state that something more than a bookkeeping entry is required before income will be considered to have been set aside.

Underlying the conclusion of [REDACTED] that the [REDACTED] did not qualify as a proper set aside was the finding that the fraternity's publication served substantial nonexempt administrative and social purposes, and the claimed educational aspects of the publication were at most minimal. The fraternity has suggested that [REDACTED] by not allowing the fractionalization approach, is in conflict with PLR 8452005 which allowed an allocation between exempt and nonexempt activities.

As a preliminary matter we note that section 6110(j)(3) provides that written determinations such as PLR 8452005 are not to be cited as precedent. Therefore, the fraternity can not rely on rulings issued to other taxpayers for any variety of reasons. However, even if PLR 8542005 had any precedential effect, and an organization can fractionalize certain activities to determine the portion devoted to exempt purposes, it would not benefit the fraternity because it can readily be distinguished from the fraternity in the earlier ruling.

The instant case can be distinguished from PLR 8452005 by the fact that Y, the separate fund in the ruling, was not restricted (as is the [REDACTED] to carrying out an activity with a substantial nonexempt purpose. The allocation of expenses between exempt and nonexempt purposes in PLR 8452005 assured that the amounts set aside were expended exclusively for exempt purposes.

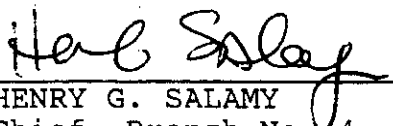
More importantly, the activities considered in PLR 8542005, the chapter visits by the fraternity's Chapter Consultant as well as the fraternity's national meetings, were conducted for substantial exempt as well as nonexempt purposes. In contrast, "[REDACTED]" primarily served the fraternity's social and administrative purposes, and only incidentally served any educational purpose. While an allocation may be proper where substantial exempt as well as nonexempt purposes are intertwined in particular activities, no such allocation is warranted for an activity such as the publication of "[REDACTED]" which is carried out without a substantial exempt purpose.

In conclusion, we believe that no allocation between the educational and other material in "[REDACTED]" is proper and that none of the investment income in the [REDACTED] qualifies as a set aside excludable from the fraternity's unrelated business income as exempt function income.

If you have any further questions or need additional assistance in this matter, please contact Ronald B. Weinstock of this office at FTS 566-3345.

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Director

By:


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